

**MARICOPA HEALTH PLAN  
(A CONTRACT OF MARICOPA  
INTEGRATED HEALTH SYSTEM)**

**YEARS ENDED JUNE 30, 2008 AND 2007**



# BEACH, FLEISCHMAN & CO., P.C.

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## Independent Auditors' Report

Board of Directors  
Maricopa Health Plan  
Phoenix, Arizona

We have audited the accompanying statements of financial position of Maricopa Health Plan (MHP), a contract of Maricopa Integrated Health System, as of June 30, 2008 and 2007 and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of MHP's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards established by the AICPA Auditing Standards Board. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MHP's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 1, MHP is a health plan of Maricopa County Special Health Care District (the District) d/b/a Maricopa Integrated Health System (MIHS), a statutory Special Health Care District and political subdivision of the State of Arizona, and is subject to *Governmental Accounting Standards* issued by the Governmental Accounting Standards Board. The accompanying financial statements have not been presented in accordance with *Governmental Accounting Standards*, but have been issued in accordance with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Maricopa Health Plan, a contract of Maricopa Integrated Health System, as of June 30, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information on pages 11 through 20 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

*Beach, Fleischman & Co., P.C.*

October 24, 2008

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**MARICOPA HEALTH PLAN  
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**STATEMENTS OF FINANCIAL POSITION**

**JUNE 30, 2008 AND 2007**

**ASSETS**

	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 12,948,338	\$ 2,742,960
Short-term investments		2,992,500
Reinsurance receivable	8,634,710	8,831,546
Settlements receivable, current	9,416,954	11,791,024
Capitation and supplemental revenue receivable	527,980	696,228
Interest receivable		54,497
Other current assets	<u>602,111</u>	<u>930,707</u>
Total current assets	<u>32,130,093</u>	<u>28,039,462</u>
Settlements receivable, net of current portion	2,354,238	1,584,815
Other assets	612,875	
Investments		<u>2,070,750</u>
	<u>2,967,113</u>	<u>3,655,565</u>
	<u>\$ 35,097,206</u>	<u>\$ 31,695,027</u>

**LIABILITIES AND NET ASSETS**

Current liabilities:		
Accounts payable	\$ 20,000	\$ 7,604
Due to MIHS	77,669	
Accrued administrative costs	893,861	873,635
Medical claims payable	23,682,462	24,965,362
Other current liabilities	<u>139,899</u>	<u>185,202</u>
Total current liabilities	<u>24,813,891</u>	<u>26,031,803</u>
Commitments and contingencies		
Unrestricted net assets	<u>10,283,315</u>	<u>5,663,224</u>
	<u>\$ 35,097,206</u>	<u>\$ 31,695,027</u>

See notes to financial statements.

**MARICOPA HEALTH PLAN  
(A CONTRACT OF MARICOPA INTEGRATED HEALTH SYSTEM)**

**STATEMENTS OF ACTIVITIES**

**YEARS ENDED JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
Revenues and gains:		
Capitation premiums	\$112,398,397	\$100,281,090
PPC capitation	11,864,983	7,918,433
Hospital supplement	3,985,445	3,620,981
Delivery supplement	4,892,581	4,670,952
HIV-AIDS supplement	682,954	686,536
PPC settlement	2,430,231	8,342,794
TWG settlement	157,592	702,047
TMC settlement	182,902	
Investment income	<u>467,829</u>	<u>355,771</u>
Total revenues and gains	<u>137,062,914</u>	<u>126,578,604</u>
Health care expenses:		
Hospitalization expenses:		
Hospital inpatient	40,366,827	42,075,062
PPC - hospital inpatient	<u>15,521,850</u>	<u>13,472,086</u>
Total hospitalization expenses	<u>55,888,677</u>	<u>55,547,148</u>
Medical compensation:		
Primary care physician services	5,873,928	4,446,284
Referral physician services	16,012,668	16,252,191
PPC - physician services	<u>2,926,748</u>	<u>2,716,649</u>
Total medical compensation expenses	<u>24,813,344</u>	<u>23,415,124</u>
Other medical expenses:		
Emergency services	10,003,980	9,663,042
Pharmacy	9,402,361	8,960,228
Lab, X-ray and medical imaging	7,875,465	9,870,694
Outpatient facility	7,286,767	11,236,461
Durable medical equipment	829,181	868,527
Dental	6,345,829	5,841,814
Transportation	3,413,403	3,408,765
NF, home health care	3,153,283	3,789,778
Physical therapy	611,892	498,077
Miscellaneous medical expenses	303,640	405,243
PPC - other medical expenses	<u>2,327,097</u>	<u>2,058,243</u>
Total other medical expenses	<u>51,552,898</u>	<u>56,600,872</u>
Total health care expenses	<u>132,254,919</u>	<u>135,563,144</u>

See notes to financial statements.

**MARICOPA HEALTH PLAN  
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**STATEMENTS OF ACTIVITIES (CONTINUED)**

**YEARS ENDED JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
Total health care expenses (continued):		
Less:		
Reinsurance	\$ 14,668,770	\$ 16,269,159
PPC - reinsurance	(415,098)	1,577,588
Third party liability	<u>183,122</u>	<u>188,783</u>
Total net health care expenses	<u>117,818,125</u>	<u>117,527,614</u>
Administrative expenses:		
Management fees	11,624,170	10,679,989
Interest		(22,992)
Other		<u>750</u>
Total administrative expenses	<u>11,624,170</u>	<u>10,657,747</u>
Premium taxes	<u>3,000,528</u>	<u>2,699,908</u>
Total expenses	<u>132,442,823</u>	<u>130,885,269</u>
Excess (deficiency) of revenues over expenses	4,620,091	(4,306,665)
Net unrealized gains on investments other than trading securities		<u>157,505</u>
Increase (decrease) in unrestricted net assets before capital contribution	4,620,091	(4,149,160)
Capital contribution from MIHS		<u>3,291,544</u>
Increase (decrease) in unrestricted net assets	4,620,091	(857,616)
Unrestricted net assets, beginning	<u>5,663,224</u>	<u>6,520,840</u>
Unrestricted net assets, ending	<u>\$ 10,283,315</u>	<u>\$ 5,663,224</u>

See notes to financial statements.

**MARICOPA HEALTH PLAN  
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**STATEMENTS OF CASH FLOWS**

**YEARS ENDED JUNE 30, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Increase (decrease) in unrestricted net assets before capital contribution	\$ 4,620,091	\$ (4,149,160)
Adjustments to reconcile increase (decrease) in unrestricted net assets to net cash provided by (used in) operating activities:		
Net unrealized gains on investments		(157,505)
Net realized (gains) losses on investments	(10,099)	88,548
Amortization of investment securities	(26,651)	(36,726)
Changes in operating assets and liabilities:		
Reinsurance receivable	196,836	(3,055,324)
Settlements receivable	1,604,647	(9,044,842)
Capitation and supplemental revenue receivable	168,248	(337,019)
Interest receivable	54,497	86,222
Other current assets	328,596	(615,389)
Other assets	(612,875)	
Accounts payable	12,396	7,604
Due to MIHS	77,669	
Accrued administrative costs	20,226	197,790
Medical claims payable	(1,282,900)	3,933,764
Other current liabilities	(45,303)	51,754
Total adjustments	<u>485,287</u>	<u>(8,881,123)</u>
Net cash provided by (used in) operating activities	<u>5,105,378</u>	<u>(13,030,283)</u>
Cash flows from investing activities:		
Collections from related party		1,500,000
Proceeds from sales of investments	89,600,000	70,606,453
Purchases of investments	<u>(84,500,000)</u>	<u>(61,000,000)</u>
Net cash provided by investing activities	<u>5,100,000</u>	<u>11,106,453</u>
Cash flows from financing activities:		
Contributed capital from MIHS		<u>3,723,694</u>
Net cash provided by financing activities		<u>3,723,694</u>
Net increase in cash and cash equivalents	10,205,378	1,799,864
Cash and cash equivalents, beginning	<u>2,742,960</u>	<u>943,096</u>
Cash and cash equivalents, ending	<u>\$ 12,948,338</u>	<u>\$ 2,742,960</u>

See notes to financial statements.

**MARICOPA HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS**

**YEARS ENDED JUNE 30, 2008 AND 2007**

1. Description of business and summary of significant accounting policies:

Organizational structure:

Maricopa Health Plan (MHP) provides health plan services to enrollees under an acute care contract with the Arizona Health Care Cost Containment System (AHCCCS) in Maricopa County, Arizona. Effective October 1, 2005, Maricopa County Special Health Care District (the District) d/b/a Maricopa Integrated Health System (MIHS), a statutory Special Health Care District and political subdivision of the State of Arizona, assumed the operations and financial responsibility for MHP, which was previously operated by Maricopa County. MHP has a contract with University Physicians Healthcare (UPH) to provide comprehensive management and administrative services necessary for the operation of the Plan. The accompanying financial statements pertain to the health plan only and do not include any accounts of the District.

Basis of presentation:

Although MHP is subject to *Governmental Accounting Standards* issued by the Governmental Accounting Standards Board, the accompanying financial statements have been presented in accordance with U.S. generally accepted accounting principles.

Use of estimates:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Capitation premiums:

Capitation premiums include revenue earned under contracts that require MHP to provide health care services to subscribers of the contracting agency for monthly capitation fees as agreed upon by MHP and the contracting agency. Amounts receivable under these contracts are recorded as capitation and supplemental revenue receivable.

Supplemental revenue:

Hospital and HIV/AIDS supplemental revenue is recognized when a member is identified as being eligible for these supplemental programs. Delivery supplement revenue is recognized upon delivery of a child by a member assigned to MHP.

Settlement revenue:

Receivables from the State of Arizona for prior period coverage reconciliation (PPC) revenue, represents MHP's profit or loss in excess of 2% for the population and is estimated based upon the State's applicable policy. Because the settlement is subject to change based on claims experience, there is at least a possibility that recorded settlements will change by a material amount in the near term.

**MARICOPA HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2008 AND 2007**

**1. Description of business and summary of significant accounting policies (continued):**

**Settlement revenue (continued):**

Receivables from the State of Arizona for the Title XIX Waiver Group (TWG) reconciliation, represents MHP's profit or loss for these members in excess of 3% for the population through September 30, 2008. This reconciliation was not effective for the period October 1, 2006 through September 30, 2007. Because the settlement is subject to change based on claims experience, there is at least a possibility that recorded settlements will change by a material amount in the near term.

Receivables from the State of Arizona for temporary medical reconciliation (TMC) revenue, represents MHP's risk of profit or loss in excess of 2% for the population and is estimated based upon the State's applicable policy. This program was discontinued effective July 14, 2008. Because the settlement is subject to change based on claims experience, there is at least a possibility that recorded settlements will change by a material amount in the near term.

**Excess (deficiency) of revenues over expenses**

The statements of activities include excess (deficiency) of revenues over expenses. Changes in unrestricted net assets that are excluded from excess (deficiency) of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

**Cash and cash equivalents:**

Cash and cash equivalents consists of cash on hand, cash and investments held by the Maricopa County Treasurer. All investments are stated at fair value.

Cash is advanced to MHP as needed to fund expenditures. Advances are deposited with high quality financial institutions. At times, such investments may be in excess of the FDIC insurance limit; however, management does not believe it is exposed to any significant credit risk on cash and cash equivalents.

**Investments:**

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the statement of financial position. Investment income or loss (including realized gains and losses on investments) is included in the excess (deficiency) of revenues over expenses unless law restricts the income or loss. Unrealized gains and losses on investments are excluded from the excess (deficiency) of revenues over expenses.



**MARICOPA HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2008 AND 2007**

**1. Description of business and summary of significant accounting policies (continued):**

**Reinsurance:**

MHP receives insurance coverage from the State of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The reinsurance expense is reflected as reduced capitation rates paid to MHP. Under the state program, risk of loss for inpatient claims is generally limited to an annual deductible of \$15,000 to \$20,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid at 75% to 85% with no maximum annual benefit. Eligible reinsurance claims are reported in the accompanying financial statements as a reduction of health care expenses at the amount expected to be collected from AHCCCS. Reinsurance receivable represents management's best estimate and is calculated based on a percentage of inpatient costs incurred. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term. Included in estimated reinsurance recoveries for 2007 is approximately \$3,400,000 that relates to services provided in 2006. Additionally, MHP recorded a decrease in estimated reinsurance recoveries of \$943,000 during 2008.

**Medical claims payable:**

The cost of hospital and medical services provided to enrollees served under contract are accrued in the period that the services are rendered. Provision has been made for claims in process of review and for claims incurred but not received at year end. The amount of this liability is computed using historical claims payment experience coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is at least a possibility that recorded estimates will change by a material amount in the near term. Management believes that the health care claims payable is adequate. Included in health care expenses for 2007 is approximately \$4,400,000 that relates to services provided in 2006. Additionally, MHP recorded a decrease in estimated hospital and medical expenses of \$4,200,000 during 2008.

**Administrative expenses:**

Administrative expenses are recognized monthly as incurred and consist of the management fee paid to UPH for the management of the Plan.

**Premium tax:**

The State of Arizona imposes a premium tax on capitation payments paid to the Plan by AHCCCS. The Plan receives the premium tax from AHCCCS and remits the entire amount to the appropriate taxing authority. The Plan includes the taxes collected as revenues and taxes remitted as an expense in the accompanying statement of activities.

**MARICOPA HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2008 AND 2007**

1. Description of business and summary of significant accounting policies (continued):

Income taxes:

As a governmental unit or a political subdivision thereof, MHP is exempt from federal income tax under Section 115(1) of the Internal Revenue Code. MHP is also exempt from state income taxes. Accordingly, no provision is made for income taxes in the accompanying financial statements.

2. Investments:

At June 30, 2008, MHP had liquidated its investments. At June 30, 2007, MHP's investments consist of U.S. government obligations. MHP's investment income consists of the following:

	<u>2008</u>	<u>2007</u>
Interest and dividends	\$ 457,730	\$ 444,319
Net realized gains (losses)	<u>10,099</u>	<u>(88,548)</u>
	<u>\$ 467,829</u>	<u>\$ 355,771</u>

3. Commitments and contingencies:

AHCCCS performance measures:

MHP's contract with AHCCCS requires the Plan to be in compliance with certain financial and nonfinancial covenants as defined. At June 30, 2008 and 2007, MHP was in compliance with these covenants.

For 2008 and 2007, substantially all of MHP's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS programs is dependent upon governmental policies. This contract is subject to renewal at a future date. MHP has been awarded its AHCCCS contract renewal through September 30, 2011. The loss of this contract would have an adverse effect on MHP's future operations.

Contract with UPH:

In October 2005, MHP entered into a management agreement with UPH. As a condition of the transfer of management to UPH, MIHS contributed initial capital in the amount of \$5,347,350, representing the initial minimum capitalization requirements of AHCCCS. The contract provides for incentive payments to UPH should UPH increase revenues and/or reduce medical expenses, as defined. At June 30, 2008 and 2007, no incentive awards have been earned by UPH.

**MARICOPA HEALTH PLAN  
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**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**

**YEARS ENDED JUNE 30, 2008 AND 2007**

**3. Commitments and contingencies (continued):**

**Letter of credit:**

MHP has secured an irrevocable letter of credit in the amount of \$8,200,000 with JP Chase Morgan to fulfill the performance bond requirement of the AHCCCS contract.

**Health care regulatory environment:**

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that MHP is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

**4. Related party transactions:**

At June 30, 2008, MHP had \$77,669 in payables due to MIHS for expenses paid on the Plan's behalf.

**5. Functional expenses:**

MHP provides health care services to residents within its geographic locations. MHP incurs general and administrative expenses for various activities, including management and administrative activities, which support the provision of health care services. A summary of expenses related to providing these services for the years ended June 30 are as follows:

	<u>2008</u>	<u>2007</u>
Health care services	\$125,590,912	\$126,551,701
General and administrative	<u>6,851,911</u>	<u>4,333,568</u>
	<u>\$132,442,823</u>	<u>\$130,885,269</u>